



**Final Minutes
Endowment Fund Investment Board (EFIB) Regular Meeting
December 14, 2004**

The regular meeting of the Endowment Fund Investment Board was held on Tuesday, December 14, 2004. Chairman Dean Buffington called the meeting to order at 9:43 a.m. and recognized that a quorum was present.

Members Present:

M. Dean Buffington
Representative William W. Deal
Gavin M. Gee
Thomas F. Kealey
Senator Brad J. Little
Dr. Richard L. Miller
William D. Mitchell
R. John Taylor
Parker G. Woodall

Staff Present:

Matthew J. Haertzen
Connie M. Eshelman
Andrew M. Potter
Angela R. Zirschky

Members Absent:

None

Guests:

Brian Hayes, RBC Dain Rauscher
Michelle Soderlund, Pinnacle Pension Services
Doug Bates, Clearwater Investment Advisors
Mike Boren, Clearwater Investment Advisors
Julie Weaver, Deputy Attorney General
Bill Reese, Judges' Retirement Fund
Corrie Keller, Judges' Retirement Fund
Roland Gammil, Judges' Retirement Fund

1. Minutes of the August 25, 2004 Regular Meeting: Approved

A motion was made by Parker Woodall, second by Representative William Deal to approve the August 25, 2004 meeting minutes. The motion carried unanimously.

2. State Insurance Fund (SIF) Reports: *Presented by Matthew Haertzen, Investment Manager, EFIB and Brian Hayes, RBC Dain Rauscher*

Brian reported that he and the Endowment Fund staff met with the State Insurance Fund on Monday, December 13, 2004 to discuss SIF's overall performance.

Mr. Hayes noted that the Fund has met all its performance parameters except the managers above median/indices for rolling three years which could not be evaluated as the managers have not been in place three years

Actual asset allocations are in-line with targets with 12% invested in equities and 88% invested in fixed income. A new addition to the portfolio is TIPS with a weighting of approximately 5%. The total fund was up 1.97% during the 3rd quarter.

Manager specifics were reviewed during the EFIB performance report.

3. Judges' Retirement Fund (JRF) Reports: *Presented by Matthew Haertzen, Investment Manager, EFIB and Brian Hayes, RBC Dain Rauscher*

Mr. Hayes reported that he and the Endowment Fund staff met with representatives from the Judges' Retirement Fund on Monday, December 13, 2004 to discuss the JRF performance.

The Fund structure was changed significantly over the past several months. One equity manager, Tom Johnson, was terminated and two new equity managers were hired. In review of the Fund's Quarterly Compliance, Mr. Hayes noted that the JRF three-year objectives are similarly structured to SIF's except for two objectives that are specific for a retirement fund. Additionally, two objectives were not met. Those objectives were 1) The ability to obtain excess returns to increase the retiree's annuity and 2) The ability to achieve an 8.25% annualized return. Both of these objectives were not met as market conditions did not provide for an adequate return during this short time period. Expectations are that these objectives will be met over a full market cycle.

Actual asset allocations are in-line with targets with 69.4% invested in equities and 30.6% invested in fixed income. The total Fund performance for the 3rd quarter was down slightly at -0.06%. The trailing one-year return was 10.21%.

Actuary Report: *Presented by Michelle Soderlund, President, Pinnacle Pension Services*

Ms. Soderlund reported that the normal cost contribution rate as of June 30, 2004 is 49.48% of the total considered compensation of the judges as defined for valuation purposes. The additional contribution rates needed to amortize the unfunded actuarial liability over periods of 15, 20, and 25 years are 16.1%, 13.3%, and 11.6% respectively. The unfunded actuarial accrued liabilities (UAAL) was \$8.4 million for fiscal year 2004 down from \$13 million in fiscal year 2003.

Ms. Soderlund attributed the reduction in the UAAL to 1) Gains in assets 2) Below expectation increases in cost of living and salaries and 3) Retirees that deceased prior to expectations. Although some progress has been made, Ms. Soderlund noted that there is still \$8.4 million in UAAL and the current level of contribution is currently not sufficient to pay the normal costs nor the amortized UAAL if all the assumptions used in the valuation are realized. Therefore, Ms. Soderlund has suggested increasing the court fees. Corrie Keller from the JRF reported that the court fees are set by statute and that the Judges' are aware of the situation.

4. Endowment Fund

A. Performance and Update: *Presented by Matthew Haertzen, Investment Manager, EFIB and Brian Hayes, RBC Dain Rauscher*

Mr. Hayes reported that the Endowment was at \$823 million as of December 14, 2004.

Mr. Hayes noted that the policy guidelines were followed as outlined in the Quarterly Performance Review. Actual asset allocations were in-line with targets with 70.5% invested in equities and 29.4% invested in fixed income. The total fund was down -0.41% during the 3rd quarter.

Manager Review:

Mastrapasqua - Mr. Hayes noted that Mastrapasqua underperformed during the 3rd quarter. Mastrapasqua continues to maintain that the current market sentiment has depressed values and expects it to rebound in the event uncertainty diminishes. As a concentrated growth manager, the expectation is for premium performance; however, it may be volatile.

Nicholas Applegate - Nicholas Applegate performed below the index and median; however, no real problems are noted, and Mr. Hayes expects that they will be able to turn their performance around and add value to the Fund.

Artisan - Artisan continues on the watch list with median results. Their ability to add value is limited due to the size of Artisan's assets under management. Their performance will be reviewed in in-depth at the February or May meeting.

Systematic – Systematic's portfolio negatives include technology stock selections and five holdings with greater than 30% loss (-4% impact on total portfolio) placing them on the watch list. Systematic was hired as an emerging manager in mid cap value and their performance will be reviewed over the full market cycle.

Marvin and Palmer - Marvin and Palmer continue to remain on the watch list. Mr. Hayes noted no particular problems with their performance. Marvin and Palmer is a deep growth international manager that follows an investment theme and at present, during a non-thematic market, their performance will seem out of touch due to their stock selection process. Their results should be viewed over a market cycle.

B. Staff Reports: Presented by Matthew Haertzen, Investment Manager, EFIB

Staff reports were as reported. Mr. Haertzen did note that the commission recapture program is going well with a total commission recapture of \$31,886 for the 1st quarter of fiscal year 2004.

C. Futures Overlay (Non Agenda Item): Presented by Mike Boren and Doug Bates, Clearwater Investment Advisors

Mr. Boren and Mr. Bates reported that the futures overlay program is running smoothly. Clearwater Investments looks at the daily position of the EFIB portfolio and compares it to the model portfolio, buying futures as needed at a very low cost to keep the Fund's asset allocation in line with targets at any given time. This program ensures that both the residual and operational manager cash flows are fully equitized to minimize the impact of cash drag on the portfolio.

Mr. Boren will report to the EFIB on the dollar value added to the Fund on a monthly basis at the February board meeting.

C. Quarterly Manager Reviews: *Presented by Connie Eshelman, Investment Officer, EFIB*

Quarterly manager reviews were as reported in the board packet and verbally during the EFIB performance report. The board had no questions or comments on the reviews.

D. Joint Finance and Appropriation's Committee (JFAC) Presentation: *Presented by Matthew Haertzen, Investment Manager, EFIB*

Mr. Haertzen reported that the fiscal year 2005 JFAC presentation is similar to the 2004 presentation. The only changes noted were to the EFIB budget consisting of the following:

1. Capital outlay increase of \$2,500 for computer server upgrades,
2. Provisions for a 27th pay period,
3. Annual inflation of 3%, and
4. CEC of 1%.

Mr. Haertzen reported that even with the inflation changes and other budget increases, the EFIB budget remains lower than the fiscal year 2003 budget.

E. Earnings Reserve: *Presented by Matthew Haertzen, Investment Manager, EFIB*

Mr. Haertzen reported that benchmarks for gains and losses were formulated during the 2004 legislative session.

The loss benchmark requires a legislative make-up of any losses after 10 years for the Public School portion of the Endowment Funds. The current loss benchmark value is \$810 million.

The gain benchmark ensures that the real purchasing value of the corpus is protected. All additional gains above the gain benchmark (currently \$894 million) will be allocated to earnings reserve.

The market value of the fund as of October 31, 2004 was \$774,824,649.

F. Alternative Asset Classes – Collateralized Debt (CLO) Program and Absolute Return Strategies: *Presented by Brian Hayes, RBC Dain Rauscher - Approved*

Mr. Hayes recapped that at the last board meeting, incorporating a CLO program and absolute return strategies into the portfolio were presented.

Mr. Hayes noted that secured collateral loans and TIPs combined would enhance the return/risk ratio by 45% and reduce the interest rate risk. The addition of this program would give further diversification to the portfolio.

Mr. Hayes recommended starting a pilot program of absolute return strategies with a \$5 million initial commitment and a long-term commitment of 10% of the total endowment, reducing the equity and fixed income allocation by 5% respectively. Active management would be utilized for both asset classes.

A motion was made by William Deal, second by Dr. Rick Miller to bring in CLO and absolute return strategy managers to the February board meeting to present on their respective asset classes. The motion carried unanimously.

G. Proposed 2005 Meeting Dates:

Because of conflicts with the proposed February board meeting date, the date was changed to Tuesday, February 15 at 12:00 p.m. All other dates will be scheduled as proposed.

Mr. Haertzen presented the option of hosting an off-site meeting in northern Idaho for the August meeting. This will allow other members of the public to attend and will lend to a retreat-type setting for the board. The board expressed interest in the off-site and will discuss further details at the February board meeting.

H. Conflict of Interest Discussion – *Presented by Julie Weaver, Deputy Attorney General*

Ms. Weaver reviewed the current disclosure statement with the board and noted that the EFIB does not have an overriding conflict of interest policy but is legally covered by its current statement. The statement was designed to give all disclosures under the state law and therefore, the existing annually signed statement is sufficient. Julie reminded the board that conflicts are not confined to personal only but are also extended to family. And at a minimum, any and all potential conflicts should be disclosed.

The Board expressed interest in having the Attorney General's Office prepare a more compact statement to clarify governing laws and gray areas at the February board meeting as well as a presentation on the code of ethics and a review of policies and procedures. Ms. Weaver asked the Board to call her with particular conflicts of concern in advance of the February meeting so that she has time to conduct any necessary research.

I. Executive Session: *Idaho Code § 67-2345* authorizes the board to enter into Executive Session for the purpose of discussing possible legal actions *§ 67-2345(1)(f)* or personnel issues *§ 67-2345(1)(b)*. Any resulting action will take place when the board resolves back into regular session.

The motion was made by William Mitchell, second by Parker Woodall to enter into Executive Session at 12:24 p.m. The roll call vote was as follows:

William Mitchell – Aye
Thomas Kealey - Aye
Senator Brad Little - Aye
Chairman Dean Buffington – Aye
Gavin Gee – Aye
Representative William Deal – Aye
John Taylor – Aye
Dr. Richard Miller – Aye

The motion carried unanimously.

Mr. Taylor departed the executive session at 12:45 p.m.

The motion was made by William Deal, second by Gavin Gee to enter into regular session. The motion carried unanimously.

Regular Session convened at 1:10 p.m.

There being no further business to come before the Board, the motion was made by William Mitchell, second by Gavin Gee to adjourn the meeting at 1:14 p.m. The motion carried unanimously.